

Missouri Securities Division

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What we are going to discuss today

- ▶ What a security is
- ▶ How securities are like drugs/medicines
- ▶ Why its important to regulate securities and who the regulators are
- ▶ Different types of securities fraud and the ever-popular Ponzi scheme

But first, a question



How are these two alike? And who is worse?



Understanding Securities

- ▶ What is a security? A security is:
 - an outlay of money to another person/company...
 - on the promise of profits, which . . .
 - come from the efforts of someone besides the investor.

Let's test our understanding



Example #1: The Mad Scientist

- ▶ The Set-up
- ▶ ***The Pitch:*** Will you invest \$1,000 in my business?
 - I will use your money to purchase the necessary equipment and supplies.
 - You will be my 50% (silent) partner.
 - Once I develop a prototype, other, bigger investors will want to buy in. When they do, you can sell to them your 50% interest—which will be worth a lot!—at whatever its valued.

Let's try another



Example #2: The Barrista

▶ The Set-up

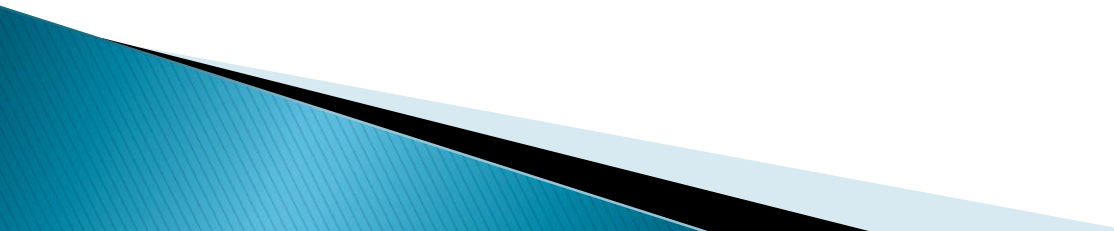
- ▶ *The Pitch*: Will you invest \$1,000 in my business?
 - I will use your money to purchase the equipment.
 - After I get more sales from my new lattes, I will return your principal to you 100% in 6 months, guaranteed! You won't have to work at all!

Let's try another



Understanding Securities

▶ Examples of Securities

- **Stocks:** you own a fraction of the company
 - **Bonds:** the company takes your money and promises to pay you back some more money in the future
 - **Mutual fund shares:** you own a fraction of the company and the company's only asset is a basket of securities (stocks, bonds, other mutual funds, etc.)
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Understanding Securities

- ▶ Q: How are securities like drugs or medicine?

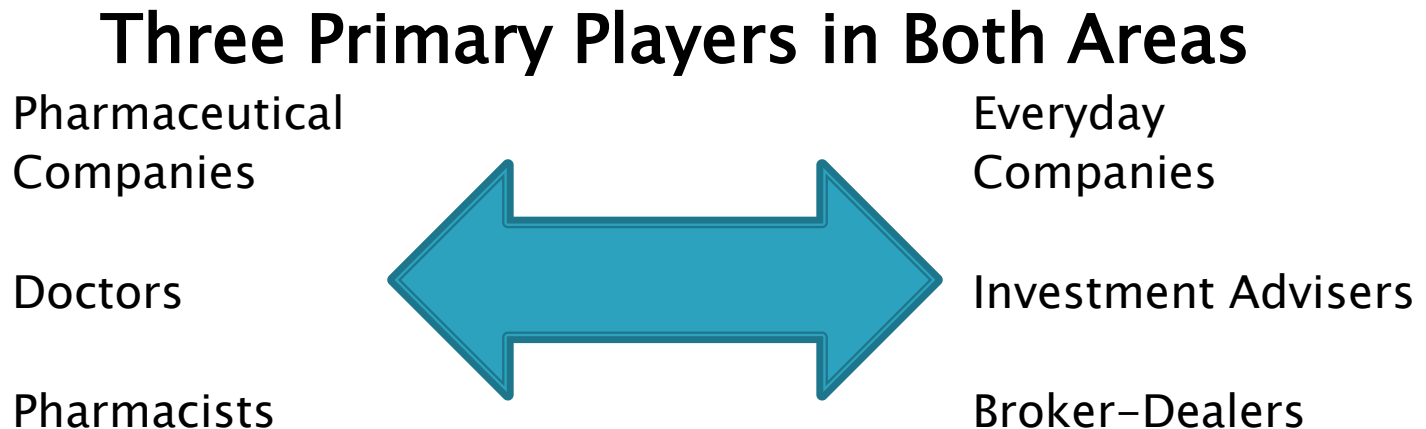


Understanding Securities

- ▶ Q: How are securities like drugs or medicine?
 - Owning or using them can benefit *or* hurt a person
 - Both are highly regulated by the government
 - Only certain people can *legally* make, offer, or sell both
 - *Lots* of people illegally make, offer, or sell both

Understanding Securities

So, if securities are like drugs or medicines, then who are the ones doing all the offering and selling of these things?



Let's explore these comparisons . . .

Who is making, offering, or selling all these drugs/securities?

- ▶ Everyday companies issue securities to raise money for new ventures.
- ▶ Like pharmaceutical companies, they don't sell directly to the public.
 - Example of Apple

But how do you know which securities are safe for you to buy?
You go to a financial doctor

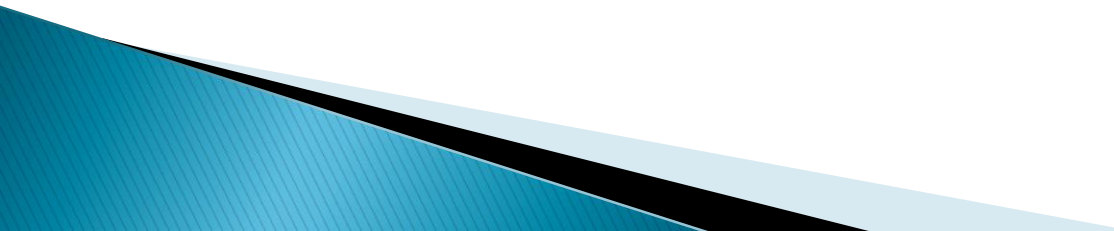


Think of investment advisers as “financial doctors”

▶ Investment advisers

- do a financial health check
- give you investment advice: they “prescribe” certain securities and investments for you to buy.

But where do you get the “prescribed” securities? You go to a financial pharmacy




Think of broker-dealers as (financial) pharmacies

- ▶ Broker-dealers sell securities to the public
- ▶ Broker-dealers, like pharmacists, generally are not allowed to give you financial prescriptions: only to fill them!

But if doctors and pharmacists are regulated, who is regulating these guys?



So, who is regulating all this?

- ▶ Q: What would happen if there were *no restrictions* on how people made drugs or who could sell those drugs?
 - Public health risks?
 - Public trust in medicines, legitimate or otherwise?
 - The businesses that made legitimate, worthwhile medicines?
 - Opportunities for fraud & deceit?
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The Regulators to the Rescue!

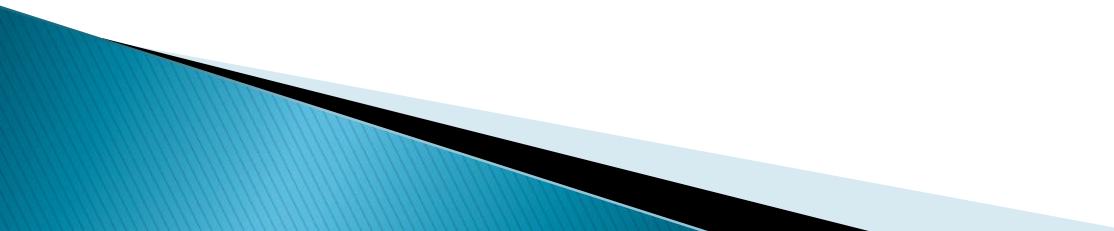
Federal: The S.E.C.



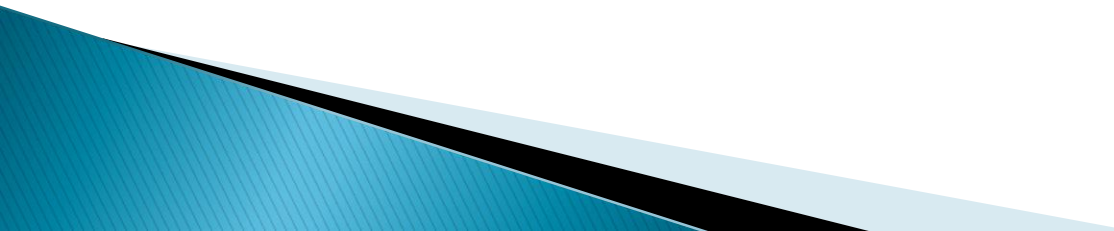
Our State: Missouri
Commissioner
of Securities



Missouri's Commissioner of Securities

- ▶ Missouri Securities Division is headed by the Commissioner of Securities.
 - ▶ Like the S.E.C., the Commissioner:
 - Regulates companies selling their securities in Missouri;
 - Regulates Missouri's investment advisers and broker-dealers; and
 - Enforces the securities laws against those who are noncompliant or acting fraudulently.
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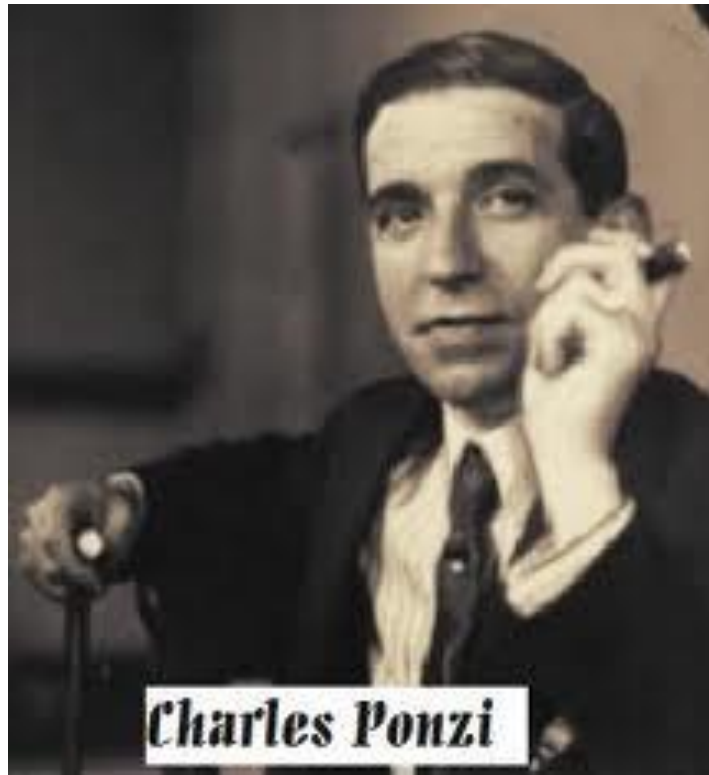
How does the Commissioner protect Missouri investors?

- ▶ The commissioner protects Missourians by telling businesses, brokers, and investment advisers:
 - How to deal fairly with Missourians,
 - What special precautions they have to take for certain investors, and
 - How to comply with the securities laws.
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Securities Fraud

- ▶ Examples of common securities fraud
 - A local businessman takes money from investors, promises to use it on expanding the business, but instead gambles it away at the boats, uses it to pay for his car, etc.
 - An investment adviser recommends to his client that he sell his mutual funds to buy certain annuities but doesn't tell him that the adviser is getting a kickback to recommend those products.
 - A broker-dealer sells a very volatile and risky stock to an elderly investor and does not tell him about that security's riskiness or that the security is not suitable for him.
- ▶ But there is one type of securities fraud that is *very* popular . . .

The Ponzi Scheme: the perennial securities fraud.



How does a Ponzi scheme work?

- ▶ Assume I am a businessman and I approach you to invest in my business. I tell you that:
 - I will run the business selling organic pet food;
 - The organic pet food business is very competitive and I have to work really hard at it; and
 - I'll return 100% of your money every quarter.

So, back to our first question



How are these two alike? And who is worse?

